The banking crisis and its effect on the markets, economy

David Hagee, Senior Vice President, Chief Investment Officer

In light of recent market volatility, *Chief Investment Officer David Hagee discusses the current disruption within the banking sector and addresses concerns Commerce Trust clients may have.*

How did we get here?

On Friday, March 10, California-based Silicon Valley Bank (SVB), with roughly $200 billion in assets, was seized by regulators in the second largest bank failure in U.S., behind Washington Mutual's 2008 implosion, and the first closure since the Great Financial Crisis of 2007–09. SVB, which was heavily tied to the venture capital (VC) industry, lacked a highly diversified depositor base, leaving the bank vulnerable to large amounts of deposits being withdrawn at any single point.

Two days earlier, SVB sought to raise capital to reinforce its balance sheet due to mounting losses in the bank's investment portfolio, alarming investors and customers alike. Some VC clients began withdrawing funds from their accounts, starting a chain reaction that spread to other SVB customers. Within 48 hours, $42 billion in deposits had been withdrawn from SVB accounts, leaving the bank insolvent and in receivership with the Federal Deposit Insurance Corporation (FDIC).

The run on SVB then rolled over to Signature Bank, a New York-based bank with a similar profile. Signature Bank's failure now ranks as the third largest in U.S. history.

Additional banks both inside and outside of the U.S. faced similar confidence challenges. First Republic Bank, a San Francisco-based regional bank struggling with cashflow issues, received a $30 billion infusion from a group of America's largest banks. Meanwhile, Swiss-based UBS agreed to purchase its troubled rival Credit Suisse, which regulators hope stems additional panic at financial institutions in Europe and beyond.

This domino effect forced the Federal Reserve (Fed) to offer a credit facility to every FDIC-bank that holds a large portfolio currently trading at a loss, providing these banks a lifeline to meet depositors' needs. The swift action by the Fed was designed to quell similar runs on other banks while providing liquidity to the marketplace.

When a bank fails, the FDIC insures deposit accounts with balances up to $250,000 per depositor. Following the seizures of SVB and Signature Bank, the Biden administration announced accounts with balances greater than $250,000 also would be covered by regulators.

Are investments with Commerce Trust safe?

Yes. Investment assets held in trust, fiduciary or custodial accounts administered by Commerce Trust are segregated from Commerce Bank's assets. In all cases, ownership of these investment accounts remains vested in the individuals or entities and the assets are not subject to the claims of creditors of Commerce Bank.

Commerce Bank ranks among the safest banks in the U.S.*

In addition, Commerce Bank is counted among the safest banks in the country. In 2022, Moody's reaffirmed the bank's financial strength by assigning Commerce an A1 baseline credit assessment. Commerce is one of only five banks in the country to hold A credit rating at this level or better.*

From an investment management perspective, Commerce Trust had limited exposure to SVB and Signature Bank for a finite number of tax-managed accounts we manage on behalf of our clients, as well as custody accounts.

How might this impact our clients' investment portfolios?

From the perspective of the financial markets, we continue to evaluate the fundamentals surrounding the markets and asset classes, specifically. We believe a diversified portfolio can help smooth returns when certain areas of the market are underperforming.

On the fixed income side of the ledger, we see these assets trading at a discount to their maturity value. We anticipate these debt instruments are likely to mature at their par value over time. Despite the possibility of trading at a loss in the short term, Commerce Trust believes it's important to continue to evaluate securities for the strength of the underlying companies, which in turn should drive repayment.

Meanwhile, we continue to anticipate churn in the equity markets. It's important to remember we've experienced a series of interest rate hikes at the fastest pace since the 1980s. We think it's likely that equities will be repriced on these higher interest rates. We also believe this is an opportunity for us to monetize this volatility, while maintaining overall diversified asset allocation, which has been shown over time to provide the greatest long-term return.

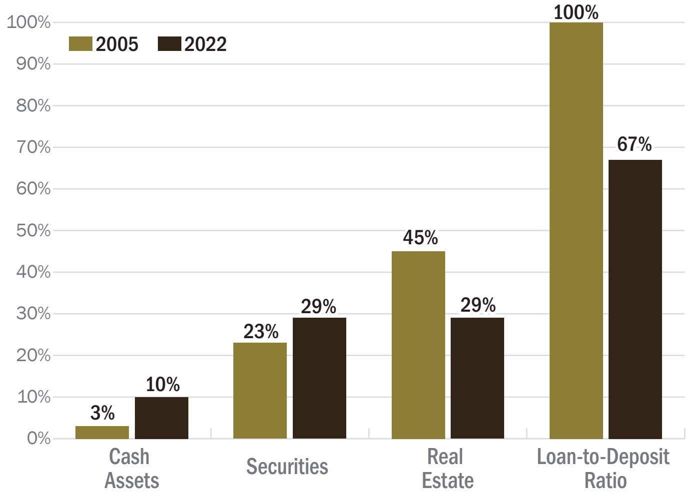
Because no investment is guaranteed, we encourage clients to discuss specific recommendations with their financial advisor.

Could this cause a ripple effect across the U.S. banking system?

While the current market situation is unsettling, the U.S. banking system remains structurally sound. Many reforms were instituted following the Great Financial Crisis to help buttress against possible bank failures. We anticipate investor sentiment toward financials is likely to remain skittish in the short term. However, we believe in the overall strength of the sector over the long run. The U.S. banking system remains well regulated and capitalized, featuring numerous banks with highly diversified portfolios, strong liquidity positions and proven records of performance over time.

BREAKDOWN OF U.S. COMMERCIAL BANK ASSETS

Bank portfolios much more diversified today than pre-Great Financial Crisis



Source: Goldman Sachs, FDIC, Commerce Trust

With regards to the Fed's ongoing efforts to tame persistent inflation, Commerce Trust expected the central bank to raise interest rates at its March meeting, even with the recent turmoil in the markets and financial services sector. This new 25-basis point increase marks the ninth straight time the Fed has raised the federal funds rate, bringing it to its current target range of 4.75–5.0%.

The Federal Reserve's rate-hiking program could soon be ending.

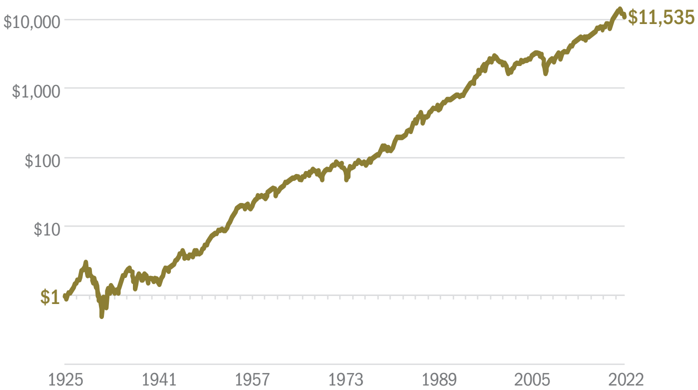
We also believe the Fed could be near the end of its rate hiking strategy. It's likely we could see one more increase to the federal funds rate in 2023, depending on how the economy, financial conditions, and most importantly, inflation evolve over the rest of the year.

The need to remain disciplined

Commerce Trust believes staying focused on long-term financial or retirement goals requires the ability to navigate through all market cycles.

VALUE OF $1 INVESTED IN THE S&P 500 INDEX

(12/31/1925 – 12/31/2022)



Source: Ibbotson.

History has demonstrated that investing opportunities tend to reward patient investors. Since 1925, the S&P 500 Index has produced a 10.1% compound annual return. So, a hypothetical $1 investment in stocks made in 1925 would have a value exceeding $11,000 today — despite all the highs and lows the market has experienced over nearly 100 years.

The recent tumult experienced in the financial markets illustrates the importance of diversification. Yet, a diversified portfolio is just one step toward a long-term strategy of investing through all market conditions. Periodically rebalancing a portfolio during extended periods of market stress also can present buying opportunities. In addition, taking the steps to de-risk a portfolio during downturns may reduce exposure to more volatile asset classes.

We recognize *peace of mind can be a scarce commodity during uncertain times. Whether it's investment management or banking concerns, Commerce Trust professionals are available to help our clients remain focused on their wealth aspirations through periods of uneasiness that can arise during market cycles.*

Contact us today.

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David Hagee

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David is the chief investment officer for Commerce Trust and Commerce Investment Advisors, Inc., the SEC-registered advisor to the Commerce Funds mutual fund complex. David has been with Commerce Bank for 23 years, during which he worked as a portfolio manager with private and institutional clients before becoming the director of portfolio management for the eastern region. David earned his Bachelor of Arts from Washington University in St. Louis. Additionally, he is a member of the CFA Institute and the St. Louis Society of Financial Analysts as well as a board member and Treasurer of Aim High St Louis. He serves as the President of the Investment Committee of the Center of Creative Arts (COCA) and serves on the investment committee of Forest Park Forever and the International Institute.